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Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

DFA INVESTMENT DIMENSIONS GROUP INC., STATE STREET BANK & TRUST COMPANY, and PNC BANK, N.A.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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147 pp

QUESTION PRESENTED

Section 546(e) of the Bankruptcy Code excepts from a bankruptcy trustee's or debtor-in-possession's avoiding powers settlement payments made "by or to" one of five types of entities, including financial institutions. The court of appeals presumed that payments made to Petitioners in a leveraged buy out merger transaction in exchange for their stock were settlement payments and found that a financial institution was involved in the transaction. The court of appeals held that Section 546(e) did not preclude this action against Petitioners by the debtor-in-possession. The question presented for review is:

1. Whether Section 546(e) bars an action by a bankruptcy trustee or debtor-in-possession to recover settlement payments made to shareholders by a financial institution in a leveraged buy out merger transaction.

LIST OF PARTIES

Respondent, Munford, Inc., was the Plaintiff-Appellant in the appeal of this case to the United States Court of Appeals for the Eleventh Circuit.

In addition to Petitioners, the following parties also were Defendants-Appellees in that appeal: Danné Brokaw Munford, as Executrix of the estate of Dillard Munford, James M. Carroll, Russell C. Fellows, Joseph W. Hardin, Jay E. Rubel, Winton M. Blount, Herbert J. Dickson, James L. Ferguson, Robert M. Gardiner, Richard K. LeBlond, Andrall E. Pearson, S.B. Rymer, Jr., and Boston Safe Deposit Trust Company.

The United States Securities and Exchange Commission is a statutory party in bankruptcy reorganization proceedings under Section 1109(a) of the Bankruptcy Code, 11 U.S.C. § 1109(a) (1994). The Commission participated in the appeal in this case as Appellee, supporting Petitioners.

In addition to the foregoing parties, Valuation Research Corporation was a defendant in the case below, but was not a party to the appeal to the Eleventh Circuit.

Petitioner, DFA Investment Dimensions Group Inc. is a mutual fund group that manages numerous portfolios, i.e., mutual funds. These portfolios are identified in the Appendix at App. 113. DFA Investment Dimensions Group Inc. has no parent companies or nonwholly-owned subsidiaries.

Petitioner, State Street Bank & Trust Company, was sued in this action only in its capacity as the trustee of two DFA Group Trusts. Its parent company is State

Street Corporation. State Street Corporation and State Street Bank & Trust Company have the following nonwholly-owned subsidiaries: Boston Equiserve Limited Partnership; Three Heritage Drive Associates; Boston Financial Data Services Inc.; European Financial Data Services Limited; High Street Investments, Inc.; State Street Bank Luxemburg, S.A.; Newport Shopping Center Limited Partnership; and Wellspring Resources LLC.

Petitioner, PNC Bank, N.A., was sued in this action only in its capacity as the trustee of two DFA Group Trusts. PNC Bank, N.A., was named in the complaint in this case as Provident National Bank. In the appeal below, Provident National Bank sought and received leave from the court to change its name in this case to PNC Bank, N.A. after Provident National Bank was merged into Pittsburgh National Bank and the new entity was renamed PNC Bank, N.A. The immediate parent of PNC Bank, N.A., is PNC Bancorp, Inc., which in turn is wholly owned by the ultimate parent, PNC Bank Corp. PNC Bank, N.A. has no nonwholly-owned subsidiaries.

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PETITION FOR WRIT OF CERTIORARI

Petitioners, DFA Investment Dimensions Group Inc., State Street Bank & Trust Company, and PNC Bank, N.A., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The order of the United States Court of Appeals for the Eleventh Circuit denying the Suggestion for Rehearing *En Banc* (App. 112) is not reported. The opinion of the United States Court of Appeals for the Eleventh Circuit (App. 1) is reported at 98 F.3d 604 (11th Cir. 1996). The opinion of the United States District Court for the Northern District of Georgia (App. 23) is not reported. The opinion of the United States Bankruptcy Court for the Northern District of Georgia (App. 52) is not reported.

JURISDICTIONAL STATEMENT

On Respondent's appeal, the United States Court of Appeals for the Eleventh Circuit, on October 28, 1996, entered a judgment reversing the district court's order in part and remanding this case to the district court for further proceedings. On July 9, 1997, the court of appeals denied Petitioners' timely-filed Suggestion for Rehearing *En Banc*, which also serves as a petition for rehearing under Eleventh Circuit Rule 35-6. In that same order, the court of appeals denied the Securities and Exchange Commission's Petition for Rehearing With Suggestion for Rehearing *En Banc*.

This Petition for Writ of Certiorari is filed within 90 days of the court of appeals' July 9, 1997, order. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1994).

STATUTORY PROVISION INVOLVED

This case involves Section 546(e) of the Bankruptcy Code, 11 U.S.C. § 546(e) (1994), which provides as follows:

§546 Limitations on avoiding powers

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in Section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

STATEMENT OF THE CASE

This case arises out of a merger transaction that took place in November 1988. Respondent, Munford, Inc. ("Munford"), as debtor-in-possession, sued Petitioners seeking to recover payments made to Petitioners in exchange for shares of Munford stock. Munford brought this action under Section 544 of the Bankruptcy Code, 11 U.S.C. § 544 (1994), and under the "constructive fraud" provision of the Georgia Fraudulent Conveyance Act, Ga. Code. Ann. § 18-2-22(3) (1991). The Bankruptcy Court recommended that Petitioners' motion for summary judg-

ment be denied. The district court rejected this recommendation, and entered an order granting Petitioners' motion for summary judgment. A divided panel of the Eleventh Circuit reversed, holding that Section 546(e) of the Bankruptcy Code does not bar this action.

A. *The Munford Leveraged Buy Out Merger*

The facts relevant to this Petition are undisputed and uncomplicated. For many years prior to the merger, Munford was a public company with its stock traded on the New York Stock Exchange.[1] At the time of the merger, approximately 3,100 shareholders owned the more than 3.9 million outstanding shares of Munford common stock.

Petitioner, DFA Investment Dimensions Group Inc., a mutual fund, and two DFA Group Trusts (hereinafter collectively the "DFA Entities") were three of those 3,100 Munford shareholders.[2] The DFA Entities owned 234,158 shares of Munford common stock. The DFA Entities invest funds primarily for the benefit of qualified pension, profit sharing, and other retirement plans. Most of the ultimate beneficiaries of their investment activities are retirees and pensioners of various companies. The DFA Entities' investment strategy focuses on extremely diversified holdings of small companies' stock for the

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[1] Munford operated 555 Majik Market convenience stores, primarily in the Southeastern United States, and a chain of World Bazaar specialty stores.

[2] Petitioners, State Street Bank & Trust Company and PNC Bank, N.A., are the trustees for the two DFA Group Trusts that owned Munford shares at the time of the merger.

long term. The DFA Entities attempt to acquire a portion of the common stock of all publicly-traded companies in a defined size range, based upon the value of the company's market capital. As a result, they hold title to the stocks of thousands of companies with the goal of achieving long-term appreciation. Consistent with this strategy, the DFA Entities acquired their shares of Munford stock gradually over a period of years beginning in 1982.

In May 1988, Munford's Board of Directors approved an agreement in principle between Munford and a group of new investors to acquire Munford by purchasing all outstanding shares of Munford stock. In August 1988, the Munford Board of Directors approved and executed the Merger Agreement, which included a purchase price of $17.00 per share of Munford stock. A Proxy Statement was sent to all Munford shareholders informing them that the Board of Directors recommended that they approve the merger.

The Merger Agreement set forth the terms and mechanics of the merger. To implement the transaction, the new investors created two companies: the Alabama Acquisition Corporation ("AAC"), and its wholly-owned subsidiary, the Alabama Merger Corporation ("AMC"). Pursuant to the Merger Agreement, Munford was obligated to proceed with the merger only if AAC or AMC deposited with Citizens & Southern Trust Company ("Citizens & Southern"), a financial institution, sufficient funds to purchase the stock owned by Munford's shareholders. (App. 56-57) The Merger Agreement provided that each share of common stock outstanding immediately prior to the merger would be converted into the right to receive the merger price of $17.00 per share. As the

Proxy Statement made clear, after the merger, old Munford's shareholders, including the DFA Entities, would possess no further ownership interest in Munford and would not participate in any future earnings and growth of the Company.

The merger was approved by Munford's shareholders, and it was closed on November 29, 1988. On that date, the new investors deposited in Citizens & Southern sufficient funds to purchase the stock of all Munford's shareholders.

The DFA Entities did not participate in the Munford merger's negotiation, planning, or implementation: they were strictly outside, minority shareholders. They had no communications about the merger with anyone connected with Munford, except for receiving the Proxy Statement. Thus, the DFA Entities were not privy to any inside, non-public, information involved in this transaction.

Prior to the merger, the DFA Entities' Munford stock certificates were held by Depository Trust Company ("DTC"). DTC is part of the nation's securities clearance and settlement system. On December 2, 1988, Morgan Guaranty Trust Company, custodian for the DFA Entities, directed DTC to surrender to Citizens & Southern the Munford shares owned by the DFA Entities and to receive the merger payment of $17.00 per share. DTC, through its nominee, Cede & Co., tendered these Munford shares to Citizens & Southern by deleting the stocks from its records and issuing a corresponding credit to Citizens & Southern. Simultaneously, Citizens & Southern credited DTC with the merger payments for the shares tendered. DTC deposited the funds in a Morgan

Guaranty account, which then credited the amounts received to the appropriate DFA accounts. (App. 81-82)

B. *Proceedings Below*

On June 17, 1991, Munford, acting as debtor-in-possession, filed this adversary action in the United States Bankruptcy Court for the Northern District of Georgia. This Petition addresses Count I of Munford's complaint, the only count that asserts a claim against the DFA Entities, in which Munford seeks to recover under Section 544(b) of the Bankruptcy Code, commonly referred to as the "strong arm" clause, the $3.9 million of merger payments the DFA Entities received for their shares of Munford stock. Munford seeks recovery solely under the "constructive fraud" provision of the Georgia Fraudulent Conveyance Act, Ga. Code Ann. § 18-2-22(3) (1991). No claim is made that the DFA Entities had any intent to defraud creditors or that they had any knowledge that the merger constituted an alleged fraudulent conveyance. The DFA Entities are the only outside shareholders sued in Count I.

Following extensive discovery, the DFA Entities filed a motion for summary judgment in the bankruptcy court on the ground that Munford's claim under Section 544(b) was precluded by the exception in Section 546(e) of the Bankruptcy Code. The bankruptcy court recommended to the district court that it deny this motion.

The district court rejected the bankruptcy court's recommendation and entered an order granting the DFA Entities' motion for summary judgment. The district court held that the merger payments made to shareholders through a financial institution acting as a clearing or

exchange agent were "settlement payments" within the meaning of Section 546(e). The court further determined that these settlement payments were made "by" a financial institution, and, thus, Section 546(e) precluded Munford's action against the DFA Entities to avoid these payments.

C. *The Court of Appeals' Decision*

A divided panel of the Eleventh Circuit reversed the district court's grant of summary judgment on Count I in favor of the DFA Entities, with Chief Judge Hatchett dissenting from that portion of the court of appeals' decision.[3] 98 F.3d 604 (11th Cir. 1996) (App. 1). The court of appeals began its analysis by describing the purpose of Section 546(e):

> Congress enacted section 546(e) "to minimize the displacement caused in the commodities and securities market in the event of a major bankruptcy affecting those industries." H.R. Rep. No. 97-420, 97 Cong., 2d Sess. 1 (1982), U.S.Code Cong. & Admin. News 583. With the passage of section 546(e), "Congress [also] sought to 'promote customer confidence in commodity markets generally' via 'the protection of commodity mar-

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[3] The district court also had entered summary judgment in favor of the Munford Board of Directors on Munford's claim that they had breached their fiduciary duty to the company in approving the merger and recommending that shareholders also approve the merger. The court of appeals affirmed that part of the district court's ruling, holding that the directors had acted in good faith and properly exercised their business judgment in an informed and deliberate manner. 98 F. 3d at 610-11.

> ket stability.'" *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (quoting Sen. R. No. 989, 95th Cong., 2d Sess. 8 (1978)).

(App. 9-10) The court of appeals then presumed that the merger payments made to Munford shareholders were "settlement payments" within the meaning of Section 546(e). (App. 12) The court of appeals nonetheless held Section 546(e) inapplicable because it determined that the settlement payment was not made "by or to" one of the entities listed in Section 546(e). (App. 12-13) The Eleventh Circuit acknowledged that a financial institution, one of the entities listed in Section 546(e), was involved in the transaction. However, the court found the financial institution never acquired a beneficial interest in the funds, and therefore believed that the financial institution was not a "transferee", as defined in Section 550 of the Bankruptcy Code, 11 U.S.C. § 550 (1994). The court of appeals concluded:

> [T]he shareholders were the only "transferees" of the funds here. And, of course, section 546(e) offers no protection from the trustees avoiding powers to shareholders; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies. Accordingly, regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities.

(App. 12-13)

Chief Judge Hatchett dissented from this part of the court of appeals' decision. He noted that Munford had deposited the funds to purchase its shares with Citizens

& Southern, a financial institution, and that Munford now sought to avoid the payments Citizens & Southern had made to shareholders. (App. 21) He stated that he believed the majority "chose to disregard the plain language of section 546(e) in order to create a new exception to its application." (App. 22) He concluded that Section 546(e) "only permits a trustee in bankruptcy to avoid settlement payments made to shareholders by a financial institution when such payments are made with actual intent to hinder, delay or defraud creditors." (App. 22)

REASONS FOR GRANTING THE WRIT

Review by writ of certiorari is a matter of judicial discretion that should be favorably exercised in those cases in which a conflict exists between or among the United States courts of appeals on an important federal question. Sup. Ct. R. 10(a). This case meets this requirement.

The decision of the court below conflicts with a previous decision of the United States Court of Appeals for the Tenth Circuit regarding the proper application of a provision of the Bankruptcy Code to leveraged buy out merger payments made by commodity brokers, forward contract merchants, stockbrokers, financial institutions, or securities clearing agencies to beneficial owners of securities. The court of appeals' decision presents an issue of substantial importance, because it permits a bankruptcy trustee (or debtor-in-possession), years after the sale of stock, to recover payments made to shareholders in a public merger transaction. This result will disrupt long-settled securities transactions and seriously

undermine confidence in the nation's securities markets. If review of the decision below is granted, that decision should be reversed because the court of appeals' construction of Section 546(e) is contrary to the plain and unambiguous language of the statute and inconsistent with Congress' purpose in enacting the statute.

I.

The Eleventh Circuit's Decision Is in Direct Conflict with a Decision of the Tenth Circuit

The Eleventh Circuit's decision in this case is in direct conflict with the Tenth Circuit's decision in *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). The court of appeals presumed that the payments to the shareholders were "settlement payments" within the meaning of Section 546(e), and recognized that a financial institution made the merger payments to the shareholders that the debtor was now seeking to avoid. Nonetheless, the court of appeals ruled that Section 546(e) did not protect shareholders from the trustee's avoiding powers because it erroneously held that Section 546(e) is only applicable to settlement payments made to one of the listed entities.

The Tenth Circuit reached the opposite conclusion in *Kaiser Steel*, which also involved payments to public shareholders in a leveraged buy out merger transaction. In the Kaiser Steel merger, the funds for the merger were deposited in Bank of America, a financial institution. 952 F.2d at 1235. After the effective date of the merger, Kaiser Steel shareholders were required to tender their shares to Bank of America in order to receive the merger payment. 952 F.2d at 1235. As with

the DFA Entities, most of the Kaiser Steel stock was in the possession of DTC. 952 F.2d at 1235. DTC tendered the Kaiser Steel stock to Bank of America, received the merger payments, and then transferred the payments to brokers or other financial intermediaries who disbursed the payments to the beneficial owners of the Kaiser Steel stock. 952 F.2d at 1235-36.

After filing for voluntary reorganization under Chapter 11 of the Bankruptcy Code, Kaiser Steel, as debtor-in-possession, sought to recover the merger payments from the shareholders who owned the Kaiser Steel stock tendered in connection with the merger. 952 F.2d at 1236. The shareholders argued that Section 546(e) barred Kaiser Steel's attempt to recover the merger payments. The district court agreed, and dismissed the claims. The Tenth Circuit affirmed.

The Tenth Circuit began its analysis by finding that the merger payments were "settlement payments" within the meaning of Section 546(e). 952 F.2d at 1237-40. The court of appeals then considered Kaiser Steel's argument that Section 546(e) does not protect a settlement payment "by" a stockbroker, financial institution, or clearing agency, unless the payment also was "to" another participant in the clearance and settlement system and not to a shareholder. 952 F.2d at 1240. The Tenth Circuit rejected this argument. It found that Section 546(e) was clear and, on its face, applied to settlement payments "by or to" a listed entity. 952 F.2d at 1240. The court of appeals refused to ignore the "unambiguous language" of the statute because the application of the language would not be absurd. 952 F.2d at 1241. Accordingly, the court held that Section 546(e) barred the claims against the shareholders.

The conflict between the decision below and the *Kaiser Steel* decision is clear. The courts of appeals addressed identical facts and came to opposite conclusions. Both cases involved the following factual circumstances:

1. The funds for a leveraged buy out merger were deposited by the purchasers in a financial institution.
2. The holders of the stock certificates—including in both cases DTC—tendered the certificates to the financial institution and received the merger payments.
3. The holders of the certificates then transferred the merger payments to the accounts of stockbrokers or other financial institutions.
4. The stockbrokers or other financial institutions then transferred the merger payments to the accounts of the shareholders who were the beneficial owners of the stock.

In both cases the debtor-in-possession sought to recover the merger payments from the shareholders, and the shareholders argued that Section 546(e) prevented such recovery. Both courts found that the merger payments to the shareholders constituted "settlement payments" within the meaning of Section 546(e). Nonetheless, at this point the two courts diverged. The Tenth Circuit held that Section 546(e) protected these settlement payments, rejecting the argument that the payments were not protected unless they were made to one of the entities listed in Section 546(e). The Eleventh Circuit held to the contrary, adopting the same reasoning expressly rejected by the Tenth Circuit. This Court should grant certiorari to resolve this conflict.

II.

Whether Section 546(e) Applies to Settlement Payments Made by a Financial Institution to Beneficial Shareholders Is an Important Federal Question

The court of appeals' decision presents an important national issue of substantial economic importance for individual investors, mutual funds, and the entire securities industry. It would permit a bankruptcy trustee (or debtor-in-possession), years after the sale of stock, to recover payments made to shareholders in a public merger transaction found to be properly recommended by the Board of Directors and approved by the shareholders. Such a recovery would undo long-settled securities transactions and undermine confidence in the nation's securities markets.

The Securities and Exchange Commission, a statutory party to this case in the court below, described the adverse consequences of the Eleventh Circuit's decision as follows:

> The effect of the panel majority's decision would be to inject uncertainty once again into the clearance and settlement system, thereby harming the system itself by subjecting its participants and investors to the risk that obligations will not be satisfied.

Petition of the Securities and Exchange Commission, Appellee, for Rehearing With Suggestion for Rehearing *En Banc* at 6, *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996) (No. 94-9046). By comparison, the Securities and Exchange Commission fully agreed with and supported the Tenth Circuit's decision in *Kaiser Steel*. In its brief to this Court, filed in opposition to Kaiser Steel's Petition

for Writ of Certiorari, the Securities and Exchange Commission stated:

> [The Tenth Circuit's] holding does not conflict with any decision of this Court or of any other court of appeals. Moreover, the decision is consistent with the plain language and purpose of the relevant Bankruptcy Code provision. Review by this Court is therefore not warranted.

Brief for the Securities and Exchange Commission in Opposition at 7, *Kaiser Steel Resources, Inc. v. Pearl Brewing Co.*, *cert. denied*, 505 U.S. 1213 (1992) (No. 91-1607).

The purchase and sale of securities in the national securities markets involves a number of participants, each of which undertakes obligations to other participants. The court of appeals' conclusion that sales of stock by the beneficial owners are not included within the statute ignores the fundamental fact that securities customers are key participants in the clearance and settlement system. Similarly, the Eleventh Circuit's reliance on the fact that the financial institutions in this case were acting as "conduits" ignores the fact that customers often use stockbrokers, financial institutions, and clearing agencies to facilitate their transactions.

Typically, a customer wishing to buy a security gives an order to a broker, who in turn purchases the security from another broker that has entered an order to sell the security for its customer. After the trade is initially agreed upon, the process that results in the ultimate delivery of the security in exchange for the purchase price is called "clearance and settlement."

This process is typically performed through a clearing agency or financial institution, with the broker for the seller being obligated to deliver the securities involved in the transaction to the clearing agency in exchange for payment of the purchase price. The broker for the buyer similarly is obligated to pay the purchase price when the securities are delivered to that broker. These obligations exist regardless of whether the person or entity on whose behalf the broker is acting fulfills its payment or delivery obligations to the broker. The failure of the customer who is buying securities to pay for them, for example, will not excuse the broker's obligation to deliver payment. Similarly, the broker for the seller must deliver securities, regardless of whether the broker itself receives delivery from the customer. Thus, even though brokers or financial institutions act on behalf of their customers, and may never have a beneficial interest in the securities, their participation is vital to the orderly operation of the nation's clearance and settlement system.

Allowing a debtor or bankruptcy trustee to reverse long-settled securities transactions would seriously disrupt this system and undermine investor confidence in the financial markets. It is important to investors (including mutual funds, retirement plans, and individual owners of stock) to have finality and stability in their securities transactions. If stockholders must worry that sales of their stock in public, above-board, arm's-length transactions are not final, substantial uncertainty among investors would result. Such uncertainty could de-stabilize securities markets and interfere with the market's ability to raise capital. The problem is exacerbated because mutual fund shareholders and group trust partici-

pants are different today than they were in 1988, so the shareholders who did not receive proceeds of the sale of a stock could be harmed if such a reversal occurred.

The diminished investor confidence that would result if long-settled securities transactions can be reversed also would create an environment hostile to capital formation. Moreover, the possibility that settled transactions can be reversed could result in greater volatility in the capital markets. Volatility is apt to increase as shareholders seek to dispose of their shares before the effective date of an LBO in order to avoid any possibility that they would be required to return the LBO proceeds in the future. As former SEC Commissioner Bevis Longstreth testified at the Congressional hearing on the enactment of Section 546(e): "A failure to perform by any participant in the chain of transactions can have serious adverse consequences for the remaining participants. Thus, the liquidity of the system is dependent upon the assumption by each participant that all of the others will perform." *Bankruptcy of Commodity and Securities Brokers: Hearings before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong. 239 (1981).

This case, which involves payments to a mutual fund and group trusts—major customers and participants in the securities clearing system on a daily basis—presents a graphic illustration of the wisdom of Congress's approach. The DFA Entities are regular participants in the securities markets and the beneficial owners of the securities (the DFA Entities actually own the securities for the benefit of their own participants, primarily retirement plans, and in that sense, are not the final beneficial owners). The DFA Entities own stock in thousands

of companies and participate in thousands of securities transactions each year. A judicial order to a mutual fund or group trust requiring it to repay payments received years before could affect the stability of the clearance and settlement process if the order placed the fund or trust in a position where it could not meet its ongoing obligations in other securities transactions.

III.

The Decision of the District Court Should Be Reinstated

The court of appeals erred in holding that Section 546(e) does not bar Munford's claim against the DFA Entities. In the crux of its decision, the court of appeals incorrectly concluded that Section 546(e) only protects those types of entities specifically listed. The court of appeals' interpretation of Section 546(e) ignores the plain and unambiguous language of the statute and is inconsistent with Congress's purpose in enacting the statute.

A. The Court of Appeals' Decision Ignores the Plain Language of Section 546(e)

This Court consistently has held that a court should follow the statute's plain meaning unless a literal application of a statute would produce a result demonstrably at odds with the intention of the drafter. *See, e.g., United States v. Ron Pair Enter.*, 489 U.S. 235, 240-42 (1989). The court of appeals misinterpreted the plain and clear meaning of the statute. Section 546(e), by its terms, prohibits a debtor such as Munford from recovering settlement payments made either "by or to" a financial institution, securities clearing agency, or stock-

broker, except in cases involving actual fraud. The statute specifically provides that this exemption does not apply to settlement payments recoverable under Section 548(a)(i), i.e., settlement payments that were made within one year prior to the bankruptcy filing with the intent to hinder, delay, or defraud creditors.

In the present case, the undisputed facts demonstrate that payment to the DFA Entities was made by a financial institution, Citizens & Southern, to a clearing agency, DTC, and that DTC then transferred the payments to another financial institution, Morgan Guaranty. The merger payments were then transferred by Morgan Guaranty to the DFA Entities' accounts. Notwithstanding these facts, the court of appeals erroneously concluded that Section 546(e) did not apply because "[n]one of the entities listed in Section 546(e)—*i.e.*, . . . a stockbroker, financial institution, or securities clearing agency—made or received a transfer/payment." 98 F.3d at 610.

The effect of the Eleventh Circuit's decision is to amend the statute so that it only applies to settlement payments made by and to a listed entity. If Congress had wanted to so limit the statute, it easily could have done so by using "and" instead of "or". The fact that Congress used "or" should not be ignored, as the Eleventh Circuit did in its decision. *See Reiter v. Sonotone*, 442 U.S. 330, 338-40 (1979) (court should not ignore disjunctive "or" and rob disjunctive terms of their independent and ordinary significance).

Comparison with Sections 362(b)(6) and 548(d)(2) of the Bankruptcy Code further confirms that Section 546(e) exempts settlement payments made "by" the listed

entities without regard to the recipient. Section 362(b)(6) creates an exemption to the automatic stay to permit setoffs by the same entities that are enumerated in Section 546(e) of certain margin payments or settlement payments. 11 U.S.C. § 362(b)(6) (1994). By its terms, this section only inures to the benefit of the listed entities; it cannot be used by other types of entities—such as beneficial owners—to avoid the operation of the automatic stay. Section 548(d)(2)(B) provides that certain margin and settlement payments received by the same enumerated entities shall be deemed to be taken for value for purposes of the Code's fraudulent conveyance provisions. 11 U.S.C. § 548(d)(2)(B) (1994). Again, however, by its terms, this section would not apply to payments received by other types of entities. In contrast, Section 546(e) employs much broader language, explicitly exempting payments when made "by" as well as "to" stockbrokers, financial institutions, and clearing agencies. The choice of starkly different language in Section 546(e) reflects a deliberate choice by Congress that the court of appeals' decision abrogates. *Russello v. United States*, 464 U.S. 16, 23 (1983) ("where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

The court of appeals effectively added an additional requirement to the application of Section 546(e) by insisting that the financial institution that made the settlement payments acquire a beneficial interest in either the funds used to make the settlement payments or the shares sold in exchange for those funds. The statute itself contains no such requirements in its plain terms.

Since a financial institution was the transferor of the settlement payments, its transferee status under Section 550 is not relevant. Moreover, such a requirement would undermine the application of Section 546(e) because it is not uncommon that the various intermediaries in the settlement of a securities transaction (for example, stockbrokers, financial institutions, and clearing organizations) do not possess a beneficial interest in the funds or securities involved. *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990). By adding this additional requirement, the court of appeals has severely limited the application of the statute, contrary to its plain meaning.

Finally, the only other court of appeals to consider the application of Section 546(e) to settlement payments made to beneficial shareholders held that the plain language of the statute required that the statute apply. In *Kaiser Steel*, the Tenth Circuit found:

> On its face the statute is clear. The statute exempts payments made "*by or to*" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is absurd or otherwise unreasonable, we can leave our inquiry at that.

952 F.2d at 1240. The Tenth Circuit examined the legislative history behind the statute, and concluded:

> Kaiser has given us no reason to replace the unambiguous language of the provision with clues garnered from the legislative history. Certainly, we cannot say that the clear application is absurd, given the fact that disruption in the securities industry—an inevitable result if lever-

> aged buy outs can freely be unwound years after they occurred—is also a harm the statute was designed to avoid.

952 F.2d at 1240-41 (citations omitted).

The court of appeals' construction of Section 546(e) is clearly at odds with the language of the statute. Review and reversal by this Court is necessary to ensure that the statute applies according to its terms as Congress intended.

B. The Court of Appeals' Interpretation of Section 546(e) Is Contrary to Congress's Intent

In light of the clear and unambiguous language in the statute, it is unnecessary and inappropriate to resort to the legislative history to glean Congress's intent. *See Union Bank v. Wolas*, 502 U.S. 151 (1991). However, an examination of the background of Section 546(e) further demonstrates the court of appeals' error. Not only does the court of appeals' decision ignore the clear and unambiguous language of Section 546(e), applying the statute according to its language is wholly consistent with Congressional intent and would further Congress's general purpose—recognized by the court below—to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions. Congress's purpose in enacting Section 546(e) (and its predecessor provision) was to provide certainty that settled securities transactions would not be reversed. The Eleventh Circuit's decision exacerbates the problem that Congress addressed when it protected the clearance and settlement system from the harm that would result if long-settled

transactions could be undone in a subsequent bankruptcy.

The predecessor provision to Section 546(e) was included in the Bankruptcy Reform Act of 1978 to correct problems caused by the decision in *Seligson v. New York Produce Exchange*, 394 F. Supp. 125 (S.D.N.Y. 1975). In *Seligson*, a bankruptcy trustee sought to recover $12 million in margin payments from a commodities clearing association on the grounds that the payments were fraudulent transfers made at a time the debtor was insolvent. The clearing association contended that it was not the transferee of the margin payments, but merely acted as a "conduit." The district court rejected this position.

William T. Bagley, Chairman of the Commodity Futures Trading Commission, testified during hearings on the Bankruptcy Reform Act that the *Seligson* decision, "if given a chance to evolve into established precedent, threaten[s] to destroy or drastically change the clearing house system." *Hearings Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary on H.R. 31 and H.R. 32 (Bankruptcy Act Revision)*, 94th Cong. 2405 (1976). Congress's response was to enact Section 764(c) as part of the Bankruptcy Reform Act, whereby Congress effectively overruled the *Seligson* decision. *See* S. Rep. No. 95-989 at 105 (1978).

In 1981, Congress further amended the Bankruptcy Code by enacting Section 546(e). Again, the Chairman of the CFTC stressed that additional amendments were necessary to eliminate any uncertainty that margin and settlement payments were transfers protected from recovery in bankruptcy. *See Hearings Before the Subcomm.*

on Monopolies and Commercial Law of the House Comm. on the Judiciary, 97th Cong. 4-5 (1981).

The court of appeals' decision, by focusing on the "conduit" status of Citizens & Southern, undermines Congress's purpose and resurrects the problem that Congress eliminated when it enacted Section 546(e). Indeed, because many securities transactions involve commodity brokers, forward contract merchants, stockbrokers, financial institutions, or securities clearing agencies that are acting as conduits, the decision by the court below largely nullifies the statute.

In Section 546(e), Congress balanced the rights of creditors against the need to protect settlement payments in appropriate circumstances. As the Securities and Exchange Commission has previously stated to this Court:

> While protecting settlement payments to shareholders will diminish the funds available for distribution to creditors, that consequence follows from Congress's balancing of the need to protect creditors against the need to protect settlement payments made by or to participants in the settlement system. By enacting Section 546(e), Congress determined that settlement payments made by or to stockbrokers, financial institutions, or clearing agencies should be shielded from the full reach of the creditor protections of the fraudulent conveyance laws, with recovery permitted only for transfers that involve actual fraud and occur within one year of a bankruptcy petition. If that scheme results in harm to creditors or others affected by an LBO, the remedy lies with Congress. See *Union Bank v. Wolas*, 112 S. Ct. at 533.

Brief for Securities and Exchange Commission in Opposition, at 13-14, *Kaiser Steel Resources, Inc. v. Pearl Brewing Co., cert. denied*, 505 U.S. 1213 (1992) (No. 91-1607).

The Eleventh Circuit's decision in this case disrupts the balance Congress sought to achieve in Section 546(e). This Court's correction of that decision is required.

CONCLUSION

The district court below and the Tenth Circuit in *Kaiser Steel* held (and Judge Hatchett agreed) that Section 546(e) bars actions to recover settlement payments made by financial institutions to beneficial shareholders. The Eleventh Circuit held to the contrary, narrowly construing the statute to not apply unless the settlement payment was made to one of the entities listed in the statute. For the reasons set forth above, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Eleventh Circuit.

Respectfully submitted,

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